



Understanding the True Potential of Hybrid Financing Strategies for Social Entrepreneurs

Maximilian Martin

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Executive Summary

Over the past thirty years, a number of social entrepreneurs have managed to create fairly large social enterprises such as Aravind Eye Care System or the Grameen Bank. They are financially sustainable and profitable, and tend to redistribute a large part of their profits through subsidized pricing to poorer client segments who cannot afford the good or service otherwise. This has led social entrepreneurs to take steps to further scale and replicate such initiatives. Properly run and scaled, many social enterprises can generate sufficient cash flow to support debt financing at manageable levels of risk and, depending on their business model and legal form, also equity and mezzanine financing.

While the social sector is large and growing, it continues to be highly fragmented – for social entrepreneurs and more classical non-profits alike. This holds back investment by raising costs and complexity. Fragmentation may lower the entry barrier for innovation, but it imposes higher transaction costs and renders expansion more difficult.

Non-profit and philanthropic leaders across a broad front have now incorporated the social entrepreneurship label into their work, as social entrepreneurship has been “mainstreamed” and integrated into global consciousness. Notwithstanding, a key question remains: how to fund social entrepreneurs efficiently? There is great enthusiasm for impact investing and social finance, as evidenced by numerous market entrants and large market estimates of up to one trillion US dollars in impact investing potential unfolding over the 2010s. However, this compares to a practical difficulty of sourcing enough quality transactions to render a large number of social investment vehicles viable on a non-subsidy basis today. Additional steps are needed to translate market potential into actual investments. This will require greater market transparency, cooperation, efficient and scalable subsidy plus investment funding mechanisms and regulatory change.

To get a practical sense of the true potential of hybrid financing strategies for social entrepreneurs, this study develops an evidence-based framework that is based on the empirical analysis of the financing approach of a number of widely recognized social entrepreneurs. We argue that the potential is significant but varies according to the subset of social entrepreneurs. Moreover, social entrepreneurs in general are well advised to derive the appropriate financing strategies for the expansion of their ventures from the first principles inherent in their business models rather than market enthusiasm. The true potential of hybrid financing strategies is significant. To fulfill the great expectations raised in the impact investing community, we need to pay close attention to the proper calibration of financing tools.

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Martin, Maximilian

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1. Introduction

Traditionally, philanthropic donations have been the primary source of funding for social entrepreneurship. This can be regarded as paradoxical given the social entrepreneurs' promotion of market mechanisms. As the field grows and matures, its sources of funding have become more diverse as well. Social entrepreneurs increasingly access different types of funding over the lifecycle of their work. They typically begin with seed grants, and later add layers of risk capital through equity and debt. In pursuing such hybrid financing strategies, social entrepreneurs mirror long-term trends that are reshaping economy and society, for example through public-private partnerships. We can expect hybrid financing strategies to gain market share over the 2010s at the expense of traditional grant-only philanthropy. This paper develops a hybrid financing framework for social entrepreneurs to help understand which financing instruments should be applied when.

In May 2011, an interesting controversy arose on the website www.nextbillion.net. The site is an online platform for academics, business leaders, NGOs, policy makers and social entrepreneurs to explore the connection between development and enterprise. Felix Oldenburg, Director of Ashoka Europe, published a contribution entitled "The Dangerous Promise of Impact Investing".¹ He argued that "the promise of channeling vast funds to social causes through impact investing actually does more damage than good [...]. Great social entrepreneurs look for the fastest way to change the system with the cheapest form of funding available – not for the safest way to produce surpluses to pay back expensive loans or mezzanine capital." In his view, business models that can create profit surpluses will not become the mainstream of social change work. Denouncing impact investing as "hype" sparked a lot of controversial discussion in the social entrepreneurship and impact investing fields. In his reply, Miguel Granier, founder of a US impact investment firm, argued that philanthropic and investment funding are fully complementary; in his view, "for-profit social enterprise and impact investing do not limit social impact by taking away dollars from the 'idea'. Rather, impact investing is a new asset class with conservative estimates predicting US\$ 400 to US\$ 500 billion worth of new impact investments over the next ten years".

Social entrepreneurship is an important driver of global change and the transformation of social capital markets. Defined as finding ways to combine existing resources in novel ways that yield added social value, social entrepreneurship is a perennial phenomenon: throughout human history, there have always been individuals who have found innovative ways to fulfill social needs. As understood today, however, social entrepreneurs typically use market mechanisms to deliver a good or a service in a highly effective fashion to a marginalized or poor population that otherwise would not have the same level of access to the good or service, or provide access to opportunities and income to a disadvantaged community. The concept of social value is key: rather than maximizing profit, social entrepreneurs maximize social impact. Social entrepreneurial ideas are now present in many areas. They include: companies that do not just look for marketable corporate social responsibility, but real engagement with communities; philanthropists who want catalytic philanthropy; and governments that promote social entrepreneurship directly to achieve cheaper or more effective provision of public goods.

Traditionally, philanthropic donations were the primary source of funding for social entrepreneurship. This can be regarded as paradoxical given social entrepreneurs' promotion of market mechanisms. As the field grows and matures, its sources of funding have become more diverse as well. Social entrepreneurs increasingly access different types of funding over the lifecycle of their work. The funding cycle typically begins with seed grants and later graduates to layers of risk capital through equity and debt. In pursuing such hybrid funding strategies, social

entrepreneurs mirror long-term trends that are reshaping economy and society, for example through public-private partnerships. We define hybrid models of financing for social entrepreneurship as providing funding via a variety of financial instruments. This includes, but is not limited to grant funding for the social entrepreneur's use of market mechanisms and entrepreneurial methods in providing goods and services to the poor or to otherwise disadvantaged communities.

In the aggregate, the use of hybrid funding strategies at the level of individual social enterprises is also reshaping social capital markets. Globalization, long-term demographic trends, changing consumer preferences, and the state of public finances together drive the emergence of an integrated social capital market for the first time in human history. Compared to the mainstream capital market, much of its funding is combining grant funding with a variety of debt and equity instruments.² In 2009, strategy consultancy Monitor estimated the for-profit segment of this so-called impact investing market alone to grow to US\$ 500 billion over the next five to ten years.³ A research report published by JP Morgan in 2010 even estimated a potential of up to US\$ 1 trillion for impact investments.⁴

There are already several market quantification studies, and much meta-level discussion on accelerating the emergence of an impact investing industry. This paper thus takes a complementary perspective. We want to look at a fundamental building bloc of any such industry, namely efficient allocation of capital to specific social entrepreneurs. This means understanding the true potential of hybrid financing strategies (grants, equity, debt, and mezzanine) for different types of social entrepreneurs. The paper develops a comprehensive, evidence-based dynamic hybrid financing framework for social entrepreneurs. There is no benchmarking data and not even a shared definition of the boundaries of the social entrepreneurship field; we thus proceed on the basis of case studies, first principles and ideal types.⁵

So what kinds of activities do social entrepreneurs conduct, and what mix of funding instruments do they require to pursue them effectively? In developing countries and emerging markets alike, social entrepreneurs target the economically active poor and disadvantaged who suffer from pent-up demand and market structures that cause and perpetuate disadvantaged access to affordable goods and services, or the productive use of the poor's capabilities. Key factors include entry barriers, lack of information, imperfect competition, insufficient vesting of property rights as well as high search, transaction and switching costs. This has caused a neglect of needs and potentials of the poor and disadvantaged by commercial market leaders.

As far as the poor are concerned, these neglected markets have been referred to as the "Base of the Pyramid" (also "bottom of the pyramid", abbreviated as "BoP").⁶ Serving the BoP, social entrepreneurs engage in a large span of activities that provide access to goods and services meeting fundamental human needs, ranging from basic goods (agriculture, housing, water and sanitation) to services (education, energy, health, and financial services). Such grants and investments facilitate job creation, energy efficiency, asset accumulation, as well as the inclusion of base-of-the-pyramid or disadvantaged suppliers in global value chains. The resulting economic and social empowerment of the end clients means that, in principle, many of these goods and services could be provided at a profit, while still achieving social transformation goals. Moreover, new BoP products and services can be a source of reverse innovation and ultimately lead to new compelling products and services in wealthy countries as well.

Thus, investors increasingly see the BoP as a significant debt and equity investment opportunity, combining considerable social impact with positive financial returns. Whether this is a general phenomenon or an exception still awaits proof. Because of their double (or triple) bottom line (people-planet-profit), social enterprises represent a more complex business model than ordinary commercial businesses. Their lead times until capital stage, when they achieve sufficient scale to cover their cost, grow to full scale and become replicable, are generally

longer.⁷ As unit margins on products destined for the BoP are generally lower, profitability will kick in only once strong volume growth has been achieved. Moreover, from a venture investment perspective, the general expectation of lower social enterprise profitability compared to commercial enterprises calls into question the classical venture capital model. If we cannot expect a few highly profitable exits to cross-subsidize the risk-taking inherent in funding a portfolio of ventures (many of which will never take off and will not return risk capital to shareholders), we need to find new investment models.

The experience of microfinance, however, where some institutions provided their early promoters and shareholders with investment yields comparable to or better than commercial businesses of a similar risk profile, demonstrates the sector's impressive potential to be profitable, at least in select cases. It has led investment funds such as the Mexico-based Ignia Fund to declare its commitment to achieving financial returns at least as high as those of mainstream businesses of the same risk class.⁸

In the industrialized world, the constraint-opportunity space is structured differently. But there is room for hybrid funding models for social entrepreneurs as well. They make sense for social entrepreneurs addressing the growing need for creative private initiatives to supplement traditional government programs in a variety of social services. The first area comprises impact business models where the provision of social goods and services generates an income from their sale on market terms. Examples are found in health and education, and in services to facilitate the integration of disadvantaged individuals into the labor market. Second, many social services are delivered by private service providers against payment of a fee by a government agency. In most cases, fees are based on input volumes, e.g. the number of participants enrolled in an education program. A recent phenomenon, the so-called "Social Impact Bonds" (SIBs) puts payments to an efficacy test.⁹ SIBs are financial instruments that tie social service payments by government agencies to the achievement of pre-defined performance targets by a social agent in select social areas. The bonds issued to pre-fund the build-up and growth of social programs pay a yield to investors based on the size of performance payments that the relevant government agency makes to the social service provider. SIBs help to increase the efficacy of social programs and allow governments to do more with less. They create win-win situations for state agencies and private investors and have the potential to revolutionize how social programs are funded and carried out. The prospects of mobilizing private capital for public good provision with greater effectiveness are relevant; think of the size of the welfare state in OECD countries and the worrying trends in public debt.

The current wave of innovation in the social sector also extends to funding mechanisms and strategies. This paper's argument unfolds as follows: based on the assumption that finance is a means to resource a specific approach to social problem solving rather than an end in itself, in section two we classify social enterprises. The key distinction is between public and private good social entrepreneurs; we also discuss microfinance institutions and small and medium enterprises (SMEs). Sections three to seven examine the hybrid financing models and experiences of four representative social enterprises in some detail. We review how their use of grants, debt, equity, and mezzanine funding serves their mission. Section eight concludes with general observations regarding the use and prospects of hybrid financing models for social entrepreneurship.

2. A Classification of Social Entrepreneurs: Public vs. Private Goods

There is a conceptual lack of clarity regarding the term of social entrepreneurship. This has implications for the understanding of financing strategies for social entrepreneurs. As "social enterprise" and "social entrepreneur" serve as umbrella terms that are used in many ways, we need to sub-segment according to the fundamental viability of their business models into public good and private good social entrepreneurs.

Financing (or "funding", used here interchangeably) is in our context a means to an end rather than an end in itself. In assessing the use of financial instruments, one must first understand what kinds of problems social entrepreneurs are trying to solve. We then need to gain clarity about the inherent sustainability of the underlying solution delivery model, and infer how to best draw on and sequence different forms of capital to resource the endeavor.

Given the conceptual lack of clarity of the term of social entrepreneurship, this is not easy. "Social enterprise" and "social entrepreneur" serve as umbrella terms that are used in many ways.¹⁰ To provide a practically useful orientation in a heterogeneous field, we need to start with two considerations.

The boundaries and definition of the unit of analysis are the first challenge. Social entrepreneurship is a dynamic phenomenon. Given the recent emergence of the social entrepreneurship field since the 1980s, most commentators and analysts adopt an essentialist view – "once a social entrepreneur, always a social entrepreneur". This may be true for the founding individuals who set up social enterprises out of a personal motivation, but it is almost certainly false with respect to the social enterprises as independent legal vehicles. Just as ventures typically enter the social entrepreneurship space coming from classical grant-based project funding, highly successful social enterprises can, at some point in their business development, exit the social enterprise space by becoming de facto large-scale commercial enterprises. This can happen after an initial public offering that creates a commercial straightjacket unless mitigated through special measures that encode the social mission in the DNA of the enterprise, for example through a shareholding pattern where a non-profit actor owns a significant portion of the company.

Second, given the considerable heterogeneity of their business models, how can we actually classify social entrepreneurs? Building on previous work, this paper argues that some classification is possible.¹¹ A grantor or investor can divide potential funding targets into two broad categories (see **concept 1**):

- *Social entrepreneurs who provide public goods.* These are typically mission-driven not-for-profit organizations that mainly create social benefits or economic benefits that cannot be monetized on markets for goods and services. In their core activity, they depend on grant funding. This dependency on grants may decline in the medium term to the extent that economic benefits such as government expenditures become monetized through payments linked to performance that feeds into monetary returns via contingent returns models such as social impact bonds.
- *Social entrepreneurs who provide private goods.* These are typically mission-driven for-profit or not-for-profit organizations that create both social and economic benefits, so that their business models are financially sustainable or even profitable. They typically begin with grant funding, but can also source forms of capital that require repayment and/or a financial return.

The group of the private good social entrepreneurs is generally more prone to benefit from hybrid funding. There are two interesting sub-categories at the commercial margin of the public-private good social entrepreneurship continuum:

- *Microfinance institutions.* Microfinance institutions (MFIs) are the most advanced and controversial subfield of social enterprise. Operating in the financial sector, they can create both economic and social value. MFIs range from very small non-profit associations that can be classified as social enterprises without much controversy to large commercial banks that cannot automatically be referred to as social enterprises. In their genesis, they share a mission to serve the poor by extending very small loans and other products to either the unemployed, poor entrepreneurs or to others living in poverty who had not been bankable. MFIs can be incorporated under a variety of different legal statuses, including foundations, cooperatives, credit unions, non-bank financial institutions or fully fledged banks. In the discussion, we treat MFIs as a sector in itself because of its size; methodologically, however, they are part of the previous group of social entrepreneurs who provide private goods/services.
- *Small and medium enterprises (SMEs) with a demonstrated social impact.* SMEs are another group of ventures at the margins of private good social entrepreneurship. SMEs are typically for-profit companies that create both social and economic benefits.¹² For example, they may offer jobs in particularly depressed areas, or produce goods and services that carry positive externalities. Whether such SMEs are in fact social entrepreneurs or mainstream commercial SMEs depends on their choices in handling eventual tradeoffs between the creation of social value and economic value. Another criterion is the degree to which profits are reinvested in the venture to enlarge its circle of clients. Clients may become small-scale entrepreneurs rather than employees, creating economic empowerment and a growing pool of capabilities for further innovation and replication.

Concept 1: Distinction between public and private good social entrepreneurs.

The public good / private good taxonomy suggests that grants are the most effective form of financing for social entrepreneurs who conduct activities that cannot reasonably be expected to ever become financially self-sustainable, because they provide social benefits rather than economic benefits. Applying economic theory, we can refer to them as *public good social entrepreneurs*. By contrast, some small and medium enterprises, microfinance institutions and small scale social entrepreneurs provide "private goods." They create a substantive economic benefit for their constituents. These organizations should be able to monetize a part of the benefits created to cover costs. This is the original idea behind for-profit microfinance, which is now being applied to goods and services at the BoP at large. Indeed, some microfinance institutions have returns on equity equivalent to or higher than some of the most successful large banks; moreover, many small and medium enterprises provide jobs but this does not automatically make them a social enterprise. In each specific case, one needs to assess to what extent they can classify as "social" enterprises. MFIs or SMEs may have started out as social enterprises, but become commercial ventures over time – and vice versa, depending on the venture's focus on social value creation.

Experience shows that hybrid funding models, that is, a mix of capacity-building grants and for profit investments, are the most effective way to support and scale *private good social entrepreneurs*.

For a summary of key dimensions of "ideal type" private good and public good social entrepreneurs, consider **Table 1**.

Dimension	Public Good SE	Private Good SE
Typical legal form	Non-profit	Non-profit or for-profit
Social mission	Embedded	Embedded
Social impact	Transformational	Transformational
Client group	BoP or ToP ¹³	BoP or ToP
Client benefits	Not monetizable	Monetizable
Business model	Unsustainable	Sustainable at scale
Key revenues	Subsidies	Goods/services sold
Running cost	Subsidy-funded	Earned income
Capital investment	Subsidy-funded	Subsidy-funded
Scale strategy	Replication & cooperation	Growth or franchising
Funding instruments	Grants & loans	All
Illustrative sector	Human rights	Microfinance
Next big thing	Contingent return funding models ¹⁴	Specialized stock exchanges

Table 1: Key Dimensions in Classifying Social Entrepreneurs

Finally, a further dimension to consider is time. Hybrid funding models can be *synchronic* – combining grant and non-grant sources of capital simultaneously to fund the joint expansion of profitable and unprofitable elements of the value chain. Or they can be *diachronic* – with hybrid funding unfolding over time, typically beginning with grant funding and then "graduating" to equity and debt funding as the venture achieves critical mass. This is the typical transition path for most private good social entrepreneurs in microfinance, base of the pyramid social enterprises, and beyond.

3. Social Entrepreneurs and Hybrid Funding Instruments

In pursuing their external financing strategies, social entrepreneurs can in principle combine the following financing instruments: grants, debt capital, equity capital and mezzanine capital. Which instruments are applicable in practice depends on the social enterprise's legal form, business model, and state of maturity.

In the previous section, we classified social entrepreneurs along a continuum ranging from public good provision to private good provision. Let us now turn to hybrid financing proper. This section analyzes specific experiences of social entrepreneurs in resourcing the common denominator of all social entrepreneurial activity: the need for capital. Capital is an essential ingredient in enabling a social entrepreneur to execute on his or her vision. The focus is on external financing: whenever social entrepreneurs generate earned income, they can finance some of the capital needs through internal sources, namely operating cash flows stemming from fee-for-service from the target clients, third-party beneficiaries or the public sector. However, internal financing is often insufficient to fund long-term business development and long-term investments such as buildings, equipment or other infrastructure. If free cash flows are too small to sustain such investments, the resulting negative operating cash flows therefore need to be funded through external financing.

In pursuing a diachronic or synchronic hybrid external funding strategy, social entrepreneurs can combine several financing instruments; they are the building blocks of any external financing mix: (1) grants; (2) debt capital; (3) equity capital; and (4) mezzanine capital. All entail specific advantages and disadvantages. The instruments are introduced here in the context of specific examples. Note that in addition to a hybrid combination of these instruments, the different instruments themselves can have a hybrid character based on jointly agreed contingencies. For example, loans can become forgivable if pre-agreed success conditions are met and investors wish to reward success by forgiving the loan. Similarly, if success is not reached, recoverable grants are converted into a grant based on milestone criteria.

This section analyzes funding models based on four examples of accomplished social entrepreneurs that are representative of specific points in the public good / private good social entrepreneurship continuum (see **figure 1**): streetfootballworld, the World Toilet Organization, Ciudad Saludable and its recycling arm Peru Waste Innovation, and Husk Power Systems. Let us now look at the prospects of hybrid funding strategies one by one.



Figure 1: The social entrepreneurship continuum.

4. Growth Funding Strategies in Sports for Development: streetfootballworld

Football for development is a powerful social change technology. The passion for football (or soccer, as it's known in the US) enables reaching out to young people to prevent the intergenerational transmission of poverty, reduce socio-economic disparities and overcome the constraints of gender discrimination. With an estimated latent demand at 45 million potential clients, the leading football-for-development umbrella organization would have to grow 113-fold to meet demand. This section examines the role of hybrid financing strategies in facilitating growth.

Let us first look at the prospects for hybrid financing strategies of an example of a recognized social entrepreneur without an earned-income model. streetfootballworld (SFW) is a global network organization that links and supports grassroots organizations which use football (or soccer) to reach young people in the pursuit of development and empowerment objectives.¹⁵ SFW has no significant revenues other than grants, its founder Jürgen Griesbeck has been recognized as a social entrepreneur by Ashoka and the Schwab Foundation, and SFW can thus be classified as a public good social entrepreneur.

SFW seeks to address the following problem: around the world, adolescence encompasses a challenging time in life when young people reach sexual maturity, face peer pressure and take on the responsibilities of adulthood. This often includes contributing to the household income and caring for family members. Adolescents who lack access to quality education, health care and active participation in society can easily find themselves without opportunities to succeed in the mainstream of society. Inequities typically become more manifest during adolescence. At-risk children are more likely to develop into potentially high-risk teenagers, who may be less likely to continue with school and be more vulnerable to health problems, risky behavior or exploitation. By reaching out to young people, SFW seeks to prevent the intergenerational transmission of poverty, reduce socio-economic disparities and overcome the constraints of gender discrimination. These are all extremely ambitious and far-reaching goals. Concretely, and drawing on the adolescents' widespread passion for football, SFW brings individuals and organizations together behind a common goal: empowering young people by providing informal opportunities to fill the gap in educating and guiding young people in contexts where formal school systems fail. Through legal entities in several countries around the world, with 45 full-time equivalent staff and a mainly grant-funded budget of US\$ 9.5 million in 2010, the SFW network serves as an umbrella to 84 organizations in 57 countries that use football to tackle social challenges like HIV/AIDS, crime and homelessness. SFW has also built a group of corporate and international partners to support these grassroots organizations, including FIFA, the FIFA World Cup, UEFA, Adidas, Sony, Ashoka, Avina Foundation, BMW Foundation, Comic Relief, the Inter-American Development Bank, Jacobs Foundation, LGT Venture Philanthropy, Open Society Foundations, the Schwab Foundation, and several ministries and governmental institutions as well as various pro-bono partners.

How does SFW drive social change, and which type of funding is best suited to move the agenda forward? SFW's core value driver is using the universal language of football as an entry point to social problem solving, thus building activities and networks around a common topic. As an intermediary organization, SFW sees the trust and the knowledge of its network members as a second value driver, brokering access to resources from global partners. Over time SFW has managed to obtain centrality in the fragmented football for development space.¹⁶ Given its umbrella strategy, SFW's explicit policy is to engage other global networks regarding best practices. Recipient of numerous awards, SFW adopted what it refers to as a "pro-collaboration" strategy: anybody who offers effective capacity development at scale to local grassroots

organizations is a possible cooperation partner.¹⁷ Rather than seeing other institutions trying to gather and steer resources for social change through football as a competitor for funding, SFW's senior management stresses its positioning at the meta-level as a resource mobilizer, with a focus on "increasing the cake" collectively and tapping into "unconverted capital" (e.g. the football industry).¹⁸ In 2010 alone the SFW network worked with over 400,000 young people around the world.

All of this may seem rather abstract. However, there is value in providing more efficient access to resources and good practices to grassroots organizations who often struggle with basic challenges such as critical mass or branding. To understand SFW's value proposition and social impact, it helps to look at the background of its founder, Jürgen Griesbeck. He first started in 1995 with a field project; later, he set up SFW as an umbrella organization, so that grassroots organizations could gain critical mass by shared access to expertise, branding and funding. His first project, "Football for Peace", set up in Medellin, Colombia, then a violent city with over 5,000 homicides per year, is illustrative of the work of many SFW network member organizations today. It used football as an instrument for building social capital. Adolescents committed to establishing a new set of rules, such as no drugs, no violence, girls actively included, no weapons, no referees in the field, and so on. Mediators encouraged the teams to resolve their differences through peaceful dialogue, while girls and boys played together to begin changing the stereotypical mindset of young males. Within two years, Football for Peace had reached out to 10,000 adolescents in order to model non-violent behavior and solutions to gang conflicts.

Later, Jürgen Griesbeck brought the same concept back to Germany. He set up "Football for Tolerance" in 2000, at a time when Germany was facing a wave of xenophobic right-wing violence after reunification. The initiative was another example of public good social entrepreneurship. Rather than building an earned-income model, the initiative focused on integration. It sought to integrate disadvantaged youth and those prone to violence, and to use football to mitigate right-wing extremism. After establishing the model, he handed it over to the local leadership, as he had done previously in Medellin. Having built two successful organizations using football as a tool for social change, he moved to the umbrella level to tackle the need for global visibility and recognition for the field of football as an instrument for social change, and set up the global network streetfootballworld in 2002. The theory of change was that effective links between organizations and supporting institutions would allow joint efforts to tackle common challenges and to overcome what were structural barriers to growth, thus enabling greater impact for the individual organizations in the network.

From a funding perspective, any umbrella strategy is most effective when it encompasses all relevant grassroots actors. What is the potential for hybrid funding strategies to help achieve this?

Mobilizing grants of more than US\$ 9.5 million in donations a year is impressive. Notwithstanding, there is still substantial potential for growth. In fact, with latent demand estimated at 45 million potential clients and 400,000 served currently, SFW or its equivalents would have to grow 113-fold to meet current estimated demand¹⁹ (see **figure 2**).

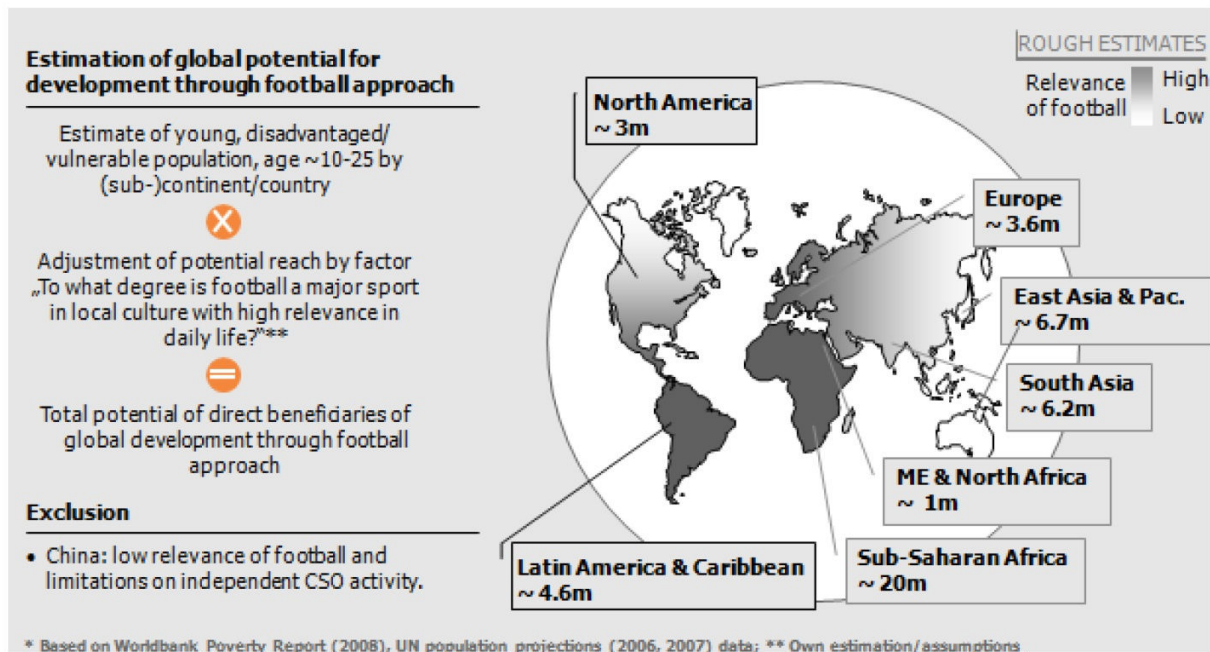


Figure 2: Estimation of the global potential for development through football approach (Source: SFW)

At first sight, SFW is an unlikely candidate for hybrid funding strategies. The organization focuses on capacity-building and aggregation for attainment of critical mass, focusing on four work streams none of which are obvious earned-income generators: (1) capacity development, to help local grassroots organizations have a greater impact on young people; (2) network development, to strengthen organizations and regions, which in turn strengthen the football for development movement as a whole; (3) partnership development, to match funding organizations with appropriate work on the ground and on a global level; and (4) advocacy, to legitimize football in general as an instrument for social change. A look at the generic SFW education and delivery model also quickly shows that it is hard to monetize the relevant but intangible benefits of the activities of the network and its member organizations (see **figure 3**). SFW operates in the paradigm of public good social entrepreneurship; this has implications for its ability to engage in hybrid funding strategies.

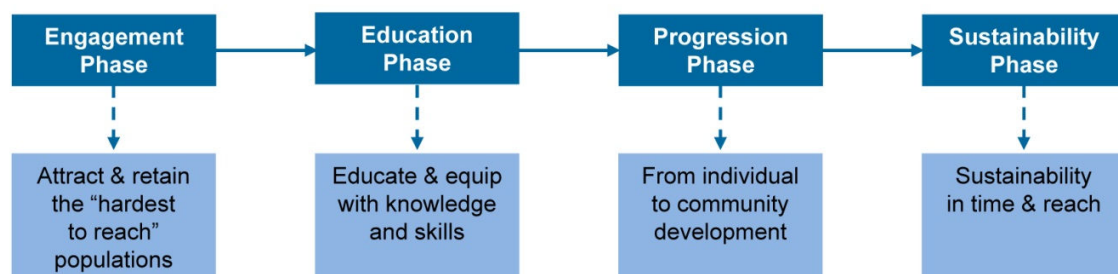


Figure 3: the SFW delivery model (Source: SFW)

Experience and research show that raising annual grant funding beyond a certain level is extremely challenging. This even holds true for organizations with an excellent value proposition, brand, and loyal donors and partners. So how can the latent demand be funded in the public good social entrepreneurship model and how is SFW currently funded? In 2011, SFW had several long-term contracts with core partners that allowed for a stable operational budget of EUR 6.9 million (for a breakdown of funding sources, see **table 2**).

PROFIT AND LOSS STATEMENT streetfootballworld gGmbH	2008	2009	2010 preliminary	2011 planned
(in thousand €)				
Sport/football confederations	2,155	3,255	5,300	2,986
Governments	290	389	467	668
Corporations/foundations	411	1,028	1,142	2,484
Income	2,856	4,672	6,909	6,138
Personnel costs	-851	-1,029	-1,019	-1,253
Non-personnel/project costs	-2,002	-3,642	-5,887	-4,881
Profit/Loss	3	1	3	4

Note: does not include other streetfootballworld entities

Table 2: SFW profit & loss statement 2008-2010 (Source: SFW Annual Report 2010)

In the 2010 budget, a vast majority of SFW funding was program-restricted, not allowing for discretionary funding of areas deemed to be of strategic importance. The vast majority of funding was in grants (see **figure 4**). Debt was negligible (see **concept 2**). As a non-profit, SFW did not receive equity or mezzanine capital investments. In the chart below, grants are represented in light blue and earned income from corporate responsibility consultancy work in dark blue.

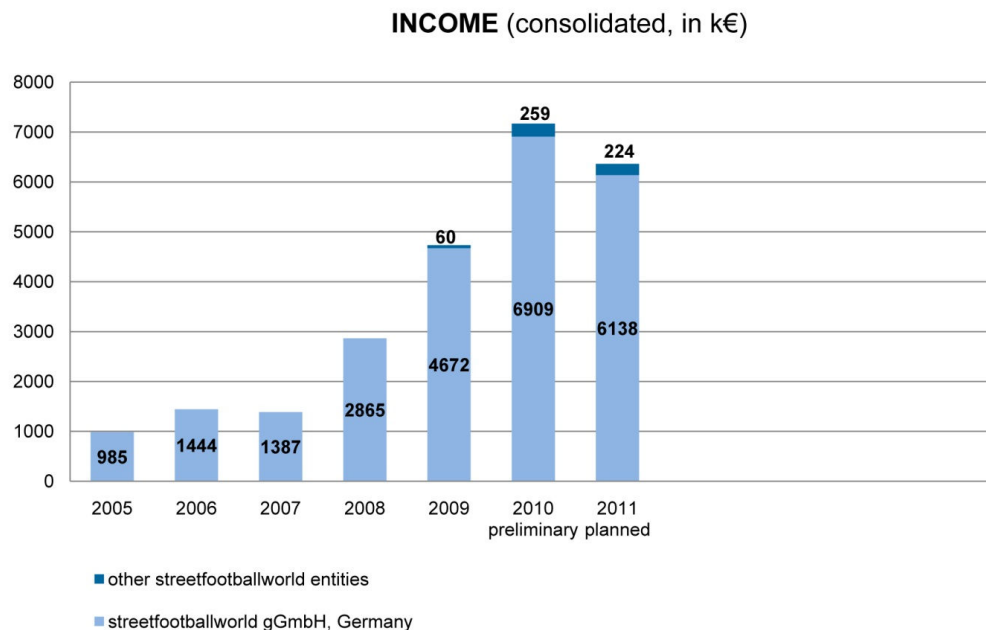


Figure 4: SFW, consolidated income growth, 2005-2011 (Source: SFW)

Concept 2: Grants and debt capital

Grants are defined as funds disbursed by one party to another party without any expectation of repayment. Grant makers typically are government agencies, charitable foundations and trusts, or private sector entities. Recipients are often non-profit entities and educational institutions, but also individuals and businesses. Grants can be provided either through money, or in-kind via volunteering or contributions. To obtain a grant, some kind of grant application or grant proposal is typically required. Most grants are made to fund a specific activity or project, requiring some level of reporting to the funder. If the grant seeker has a charitable or tax-exempt status, the funder may be able to deduct the grant or a portion of it from his tax obligations. Today, grants remain the most widely practiced model of financing social entrepreneurs. In spite of the advantage of providing capital at zero cost, there are important limitations to grant funding. First, grants are typically project specific; they exclude overhead and business development costs, and do not provide full internal allocation flexibility. Second, grants typically face a limited 3-5 year time horizon, are costly to raise – estimates range from 22-43% of the amount raised – and project-related. They are very valuable to get started, but cannot typically accompany a social entrepreneur's rising capital needs as the enterprise goes to scale.²⁰

Debt capital is defined as capital which is raised by taking out a loan. The loan is made to the social enterprise typically to be repaid at some future date. The repayment schedule may be structured depending on repayment ability. For example, a balloon payment loan does not fully amortize over the term of the loan, and leaves a large final payment, the so-called balloon payment. Unlike in the case of equity capital, subscribers to debt capital do not become part owners of the social enterprise, but remain creditors; debt capital is therefore an especially important source of external financing when social enterprises are structured as non-profits. Suppliers of debt capital usually receive a contractually fixed annual, or in some cases floating, percentage-return on their loan. They provide capital on a temporary basis, with repayment due

after a few years. The interest on debt capital must be repaid in full before any dividends are paid to any suppliers of equity. From a business development perspective, debt capital is an attractive option whenever (1) long-term investments with stable and predictable cash flows need to be funded, (2) if the social enterprise is fundamentally creditworthy and (3) able to make an annual interest payment. Seen that risk capital is typically required to take on debt and provide layers of risk, non-profits who cannot take on equity may need to raise grants that perform the layered risk function of equity. Moreover, in the event of bankruptcy, debt capital providers may have far-reaching rights on the organization's assets.

From a funding perspective, a public good social entrepreneur such as SFW who relies mainly on grant funding must have one core goal: long-term diversification of income sources, to avoid over-reliance upon any one source of income or on any one category of funder. While such a strategy is critical to ensure baseline sustainability of the organization, in the current case, with massive latent demand, it is unlikely to close the funding gap to address the latent demand.

This is likely to require alternative approaches to creating new income streams, which create a space for hybrid funding strategies. It is interesting to note SFW's first steps in this direction. In 2010, SFW received a loan from LGT Venture Philanthropy of EUR 300,000 for the development of a new donation platform – www.justunited.com – next to a EUR 300,000 grant from Avina Foundation.²¹ The donation platform is expected to become self-sustainable. Just United is a single-theme fundraising platform that will allow fans to donate directly to organizations working in the field of development through football. By linking fans directly to SFW network members in the field, it is expected to create a new income channel. Social responsibility considerations advance in all industries including football. Segments other than fans could also be converted over time, namely clubs, leagues and players, creating profits from services and products to be channeled strategically into the core business of SFW, development through football.

To close the latent demand gap, it makes sense to leverage the huge potential of the football industry to donate to social change, paired with the SFW bottom-up approach to international development. Cooperation and orchestration are essential to achieve this. Let us look at this via a back-of-the-envelope calculation. Around the world, FIFA has 205 member associations with over 300,000 clubs and more than 240 million players. The total annual turnover of the global football industry is in the order of US\$ 300 billion. If we base serving latent demand for football for development on the current cost of serving demand at linear cost, 113 times the current budget of SFW would be required. What about channeling a percentage of the turnover of US\$ 300 billion to social change, analogous to funding commitments in government development aid? Total funding of demand would cost US\$ 1.07 billion a year, or 0.36 percent of the annual turnover of the global football industry.²² As concepts of branding, merchandising and large-scale commitments expand into a professionalizing social sector, hybrid funding strategies are likely to generally play a more important role going forward: funders may be willing to provide up-front risk capital in return for a share of revenues stemming from mobilization in the future, and financial engineering can monetize future grant commitments from reputable counterparts ahead of the actual payment. Given the fundamental model of public good social entrepreneurship, such hybrid funding strategies will ultimately always relate to developing and redistributing some grant revenue stream. A mix of grants and some debt funding can be expected to play an important role in financing income-generating activities as described above, for which donation funding cannot be obtained at the outset.

5. Growth Funding Strategies in Sanitation: World Toilet Organization

Next to football for development, sanitation is another underfunded field for public good social entrepreneurship and relevant for hybrid financing solutions. With about half the population in the developing world without access to sanitation in 2011, UN Millennium Development Goal 7.C ("Halve, by 2015, the proportion of the population without sustainable access to safe drinking water and basic sanitation") appears to be out of reach – unlike the MDG drinking water target, though in some regions much remains to be done there as well, in particular with respect to drinking water for rural households and safe water supply.²³ This section examines the role of hybrid financing strategies in facilitating growth of the delivery capacity of the leading social entrepreneurship voice in the sanitation space, the World Toilet Organization (WTO).

In sanitation, the overall picture is bleak. Improvements in sanitation typically do not reach the poor, and there are enormous disparities in urban and rural sanitation coverage. It is crucial to get solutions and money for the market of 2.6 billion people who do not have a toilet. 1.5 million children die every year from diarrhea caused by poor sanitation and lack of hygiene. Sanitation is a "classical" social entrepreneurship topic: important for public health, but in desperate need of pattern change to provide access for all.²⁴ Sanitation is also generally considered to be an embarrassing topic, and this has numerous adverse consequences. It is not uncommon for adolescent girls to drop out of schools that do not have toilets once they menstruate, for fear of embarrassment when they bleed and lack of places to change sanitary pads. Even in the developed world, public toilets are far from predictable in terms of cleanliness. Diseases, dignity and inconvenience plague citizens in urban spaces, home to half of the world's population. Many governments continue to use archaic building codes, written before women's liberation, which imply that women have to queue up to public toilets when men do not have to. In many countries it is not uncommon for older women to have been socialized into learned suppression of urination: generations of women have learned to drink less water when going out, leading to dehydration. Architects are often not "toilet-trained" and tend to design solutions that are non-ergonomic and suboptimal in terms of the user experience. Finally, toilet janitors are typically badly paid and often not properly trained.

In a nutshell, there is gigantic latent demand for affordable sanitation solutions. 2.6 billion people without proper sanitation implies demand for perhaps 500 million home toilets and another 500 million toilets in schools, religious places, marketplaces, workplaces, and transport/recreational places. This could mean that one billion affordable toilets need to be supplied, rendering this a significant work stream in the overall context of getting affordable products and services to the base of the pyramid.

In spite of the magnitude of demand, the sanitation market still needs to be structured to make it inclusive. The World Toilet Organization (WTO) is a social entrepreneurship organization that seeks to play a role similar to that of SFW in football for development. WTO focuses on structuring and advancing the field of sanitation.²⁵ WTO sees itself as responsible for all toilet issues and solutions, acting as a movement together with all other stakeholders. Headquartered in Singapore, the WTO has become the de facto global social entrepreneurship voice of sanitation over the past decade. Realizing the need for a global body on the subject, its founder, social entrepreneur Jack Sim, created the World Toilet Organization in 2001 as a global network and service platform for toilet associations, academia, government, UN agencies and toilet stakeholders. The goal is to learn from one another and leverage media and corporate support that in turn would influence governments to promote sound sanitation and public health policies. WTO was intended as a pun to more effectively market a message that has been a longstanding taboo. Since its inception, WTO organized ten World Toilet Summits and two

World Toilet Expos and Forums in Bangkok, Beijing, Belfast, Hainan, Macau, Moscow, New Delhi, Philadelphia, Seoul, Shanghai, Singapore and Taipei. Today, WTO is a growing network of 235 organizations in 58 countries. It has declared its founding day – November 19, 2001 – as World Toilet Day. The day is now celebrated around the world every year. It is increasingly recognized as a point of reflection towards improving the state of toilets and sanitation globally. In 2011, WTO had 14 full-time employees, 100 volunteers, and a fully grant-funded budget of US\$ 600,000 (up from US\$ 500,000 in 2010, US\$ 400,000 in 2009, and US\$ 200,000 in 2008). WTO has received numerous recognitions.²⁶

Given massive unmet demand, which role can hybrid financing strategies play in scaling up WTO and sanitation solution provision more generally? Where SFW is developing a specific convening solution through Just United, WTO is working on a specific product solution. With the support of Index Award, the Rockefeller Foundation and the Singapore Economic Development Board it has created the SaniShop franchise model, intended to enable the poor to produce and sell small affordable sanitation systems at a cost below US\$ 40 per family.²⁷ Clients become SaniShop entrepreneurs; as commission-based sales agents with a flexible payment mechanism, they are supported with simple yet effective marketing tools.

The model is designed to be profitable and sustainable and to create jobs while delivering public health and dignity. Conceptually, the role of hybrid financing is straightforward. Seeing that the humanitarian aid community focuses to a greater extent on water, there is a funding gap in sanitation. While the donor model cannot be expected to mobilize enough resources, the market mechanism is not (yet?) working. The WTO SaniShop market-based model initially needs technical assistance grants to eventually become self-sustainable. Jack Sim estimates this phase to take perhaps another 5-8 years to reach sufficient economies of scale for self-sustainability. For example, since inception SaniShop has sold 5,400 toilets in Cambodia under CLSA sponsorship. In 2011, SaniShop will start sales in India under various sponsorships. So far, 120 sales agents have been trained and 5,400 toilets sold until the second quarter of 2011, enabling 26,000 clients to access proper sanitation through the SaniShop Program. There is still ground to cover to deliver on WTO's vision of 10 million toilets sold around the world by 2016, and 50 million toilets sold by 2020.

To highlight the pace of change given the enormity of challenges which social entrepreneurs target, after a decade of operations WTO still sees itself in a seed phase, looking for grants. As its founder points out:

"We need grants and sponsorship in the initial phase. We will only need venture capital after we go to massive scale in 2015. While we build profitability at our franchisee level, we are not going to operate at a profit providing the training, designing, and productization. We need to build up a very strong distribution branding before we can turn in a profit exploiting manufacturing at large scale volume. WTO has already built a major brand itself in the world and so extending the WTO brand transfer into the BOP distribution marketplace is a natural flow for us. Our model is to open source and bring in master franchisees that already have large distribution networks and piggy-back on them while bundling our franchise with other related products supplies and emptying services."²⁸

With respect to the field of commercial business, this stance would seem surprising. In the field of public good social entrepreneurship, it is standard. As the WTO founder points out: *"We've been 11 years in existence without any borrowings or equity injections. WTO is a non-profit organization. We are registered as a company limited by guarantee which allows us to do business as well as be a charity. We started the SaniShop model at the end of 2010 and to-date we sold 5,000 toilets in Cambodia at US\$ 33 each. We see the SaniShop model as rapidly scalable."* So far, cumulative grants to WTO since inception amount to US\$ 1.2 million; WTO

has never taken on debt, equity, and mezzanine capital. Regarding hybrid funding strategies, Jack Sim points out that WTO has never strategically mixed elements of grants, debt and equity to attain organizational funding and development objectives: *"Never before. We'd need very good hands-holding to do that."*²⁹

Notwithstanding, hybrid funding will at some point become necessary to build a large-scale market for sanitation products and services. To help achieve this, WTO has become a member of the World Sanitation Financing Facility (WSFF). WSFF is positioned as a convener and agenda-setter focused on the finance dimension of sanitation, bringing together people to realize the opportunities of the sanitation market, develop infrastructure and provide access to finance for entrepreneurs and customers in need.³⁰ To render insights actionable and fundable, WSFF has defined three work streams. First, it provides a platform for participants to brainstorm and pool expertise to generate practical solutions for financing sanitation at scale. Second, it identifies the sanitation market and various business lines and models for commercial investment. This work stream seeks to uncover and understand the best ideas across geographies and market segments so that financial products can be designed to support these businesses, both locally and at scale. Finally, WSFF aims to assist in financial innovation and a streamlined capital flow from public funders or banks and corporations to entrepreneurs and 2.6 billion potential customers. As of October 2009, approximately 30 organizations were represented, each committed to WSFF's objectives. All recognized that new thinking was required to contribute to the Millennium Development Goal target of halving the proportion of people without access to basic sanitation by 2015, and to achieving universal sanitation coverage. WSFF estimates the total sanitation market to be over US\$ 80 billion over 10 years, unlocking an additional US\$ 685 billion of positive externalities such as additional earned income due to fewer days of sanitation-related illness. These are big figures, and an intelligent combination of grant, debt and equity funding will be essential to deliver on the potential.

6. Developing a SME Activity: the Case of Healthy City Group

The disposal of solid waste is an important public management and health challenge for global society. Inadequacy of public-sector solid waste disposal services results in accumulation of masses of garbage and other forms of refuse in urban areas. This poses serious public health threats. In a shared value chain with public and private good elements, social entrepreneurs can help to address the challenge by building inclusive market places for waste pickers and community-need centric waste infrastructure. The SME components of their value chain offer significant equity and debt financing potential. This section examines the experience of a leading group in Latin America, Ciudad Saludable ("Healthy Cities"), headquartered in Peru.

The previous examples looked at hybrid funding strategies for development through football, with a latent demand of 45 million youth around the world, and sanitation, with a latent demand of one billion toilets for 2.6 billion people without access in 2011. We analyzed the examples of leading public good social entrepreneurs, namely streetfootballworld (SFW) and the World Toilet Organization (WTO). In both cases, it was clear that hybrid funding will play a role to mobilize the resources required to go to scale; however, it became also clear that key elements of the value chain will have to continue to be subsidy-funded, either from private sources (philanthropy) or via public funding. Moreover, the leading umbrella organizations in these fields still have little experience with hybrid financing strategies. The case of WTO suggests that hybrid funding make sense whenever there are products which can be monetized in case of success. The logical hybrid funding approach consists of grants in the seed phase and debt and equity instruments in the venture and capital phase. Overall market-building, however, can be expected to continue to be a subsidies-based activity.

Let us now move across the social entrepreneurship continuum toward private good social entrepreneurship and turn to the role of hybrid funding strategies in another important theater of social entrepreneurship, waste management. This section looks at an advanced example in terms of the combination of advocacy and product solutions.

The disposal of solid waste is one of the world's most critical public management and health challenges. Where public-sector solid waste disposal services are inadequate, masses of garbage and other forms of refuse accumulate in urban areas, posing serious public health threats. Currently only 30% of the solid waste in Latin America and 20% in the world are treated in a sustainable manner. Public and private initiatives to address the problem are typically slow-tracked by the high entry barriers to a solution statement: preparing professionals in solid waste management, including technical knowledge and social awareness, is required. In many developing countries, the inadequate waste management systems give rise to a fully-fledged informal industry of waste pickers. But rather than acknowledging the existence of these informal sector waste pickers and integrating them in a comprehensive affordable waste management system for the country, policy makers typically marginalize them. This is not only a lost opportunity for the greater public good. It also has direct negative public health consequences, impacting adversely on the health of waste pickers as well as creating significant adverse effects on the environment.

Healthy City Group (HCG, in Spanish "Grupo Ciudad Saludable") is a leading social enterprise in Latin America.³¹ It seeks to move from inadequate waste management systems that marginalize waste pickers to integrated and inclusive solid waste management systems that recognize the important contributions of waste pickers to the value chain and the recycling of waste. To this effect, HCG works alongside the public and private sectors in Latin America and South Asia to implement an inclusive model of integrated solid waste management. It incorporates informal waste collectors into municipal waste management systems. This model

significantly improves the livelihood of waste collectors and living conditions in their communities. It can in principle be applied in many contexts around the globe. HCG's founder, Albina Ruiz, has been working in the paradigm of local enterprises to collect and process garbage since the 1980s. She started focusing on health and environmental problems caused by garbage in Peru 35 years ago, when she moved from the interior to Lima to study industrial engineering. After her thesis, she came up with a community-managed system of waste collection for urban and rural communities. Over 15 years, she promoted and refined her model while working as a consultant to cities, industrial firms and various international development projects, and set up the non-profit organization Healthy City in 2002 in Peru. Headquartered in Lima, Peru, HCG employed 102 full-time and 32 part-time employees in 2011, and operated with a budget of US\$ 1.8 million in 2010 (US\$ 2 million in 2009 and US\$ 1 million in 2008). Always in 2010, HCG had assets of US\$ 1.5 million and liabilities of US\$ 550,000.

In its first decade, Healthy City has organized over 6,000 waste collectors, creating employment and improving health and living conditions. HCG's projects cover over 100 cities across Peru, impacting 5.6 million residents. Moreover, HCG has implemented a Master's program in Peru to educate a cohort of professionals who can apply the community-based waste collection model. In addition to HCG's direct work with waste pickers and education, the organization also engages in policy advocacy and agenda setting, seeking to replicate the model to other countries. In 2011, Albina Ruiz worked with over 100 professionals on a national solid waste management plan for Peru, while replicating the HCG waste management model in Bolivia, Brazil, Chile, Ecuador and India. To implement an inclusive model of integrated solid waste management that incorporates informal waste collectors into municipal waste management systems in Latin America and South Asia, HCG operates a mixed business model. HCG fosters local enterprises run by waste pickers to collect and process garbage. The business model consists of charging affordable fees, reducing waste volume in municipal landfills and generating greater income by separating recyclables, spinning off additional microenterprises to produce compost and other marketable by-products.

The HCG business model is itself hybrid, with elements of public good and private good social entrepreneurship. It focuses on three key areas: (1) organizing and formalizing recyclers and promoting their inclusion in municipal waste plans, (2) influencing public policy and (3) engaging public and private entities in waste management to obtain scalability of the model. The HCG input-output-outcome model is summarized in **figure 5**.

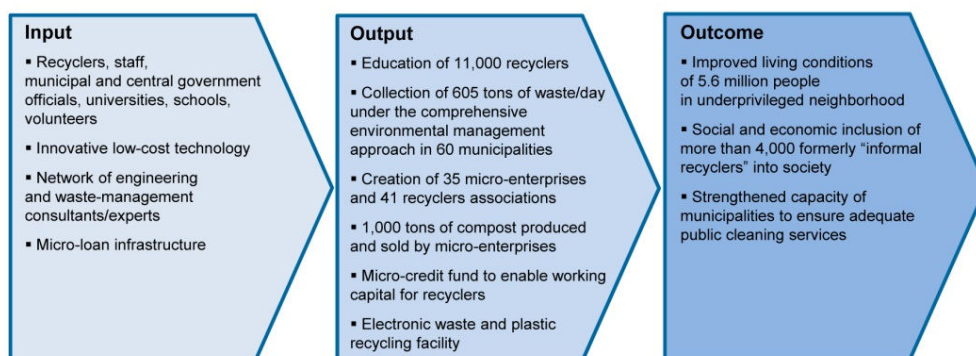


Figure 5: the HCG input-output-outcome model (Source: HCG)

To achieve its mission, in 2011 HCG comprised three organizations: Healthy City, a non-profit organization, organizes waste collectors; Peru Waste Innovation (PWI), a for-profit social business, provides consulting services in solid waste management; and finally Healthy Cities International (HCI), a foundation, is in charge of replicating Ciudad Saludable's model around the world.

Similar to the previous examples, the key question is how hybrid funding strategies could help HCG to scale its work. HCG's growth strategy centers on consolidating the model and expanding it to other countries and regions. The core of HCG's funding still are grants (US\$ 1 million in 2008; US\$ 1.6 million in 2009; and US\$ 1.1 million in 2010). But HCG has raised an equity investment for the for-profit Peru Waste Innovation company (See **concept 3**, equity capital). PWI is a leading solid waste management consulting company in Peru, and managed to attract US\$ 600,000 in equity from Liechtenstein-based LGT Venture Philanthropy as risk capital to fund its entry into the electronic waste recycling business.³² In 2010, PWI turned a small operating profit.

Concept 3: Equity capital

Shareholder equity, also referred to as risk capital, is the residual claim or interest of the most junior class of investors in assets, after payment of all liabilities. This means that if valuations on assets exceed liabilities, equity is positive. Equity capital is an attractive external financing option for social enterprises structured as for-profit entities (thus able to accommodate shareholders) to fund activities that are necessary to scale the venture, but have an uncertain payoff or income generation schedule. Unlike in the case of debt, equity does not have to be repaid. Shareholders bear the full risk of the operation, in exchange for certain control rights. In the event of bankruptcy of the social enterprise, all secured creditors are first paid against proceeds from assets. Subsequently, creditors ranked in priority sequence can exercise the next claim on the residual proceeds. Shareholders equity is then the residual claim against assets, which is paid only after the demands of all other creditors have been satisfied. Access to such risk capital is essential to scale most social enterprises. In exchange for a certain share of the company, the investor receives a share of the future profits generated by the social enterprise, rather than regular annual payments. Given the inherent riskiness of equity, investors also receive certain control and voting rights. The rights depend upon the share held in the social enterprise and the legal framework in the country where it is registered. This means that social entrepreneurs need to carefully consider whether the "DNA" of an equity investor is compatible with the values and philosophy of the social enterprise.

Looking at scaling and business model, we can conclude that a hybrid funding strategy is a must for HCG to achieve its mission. HCG needs to influence public policy in the countries in which it operates to create a legitimate marketplace for informal sector waste pickers. It is hard to see how advocacy for this model of social and economic inclusion could be resourced in ways other than through grants. On the other hand, some aspects of the HCG value chain are commonplace in any small and medium enterprise and can be profitable, such as operating waste recycling itself. Based on the organization's know how, influence and reputation, one can see how entering such business segments can be funded through venture capital. In fact, with the help of pro bono partners McKinsey & Company and Siemens In-house Consulting, HCG has already developed funding scenarios, anticipating the strategic interplay of debt and equity via venture capital, a strategic investor, as well as letters of credit and loans (see **table 2**).³³

Type of investor / contribution	
LGTVP	Strong network, strategic partner, patient capital, dedicated to mission
New Investor	Potential strategic investor; access to capital, markets and expertise
Letter of Credit	To support working capital needs
Loan	Increased leverage; expand the business and move into new lines of business

Table 2: Building blocks of HCG hybrid financing strategy

7. Hybrid Funding for SME Expansion: The Case of Husk Power Systems

An estimated 1.5 billion people around the world have no access to electricity and 85 percent of them live in rural areas. For everyone to have access to reliable electricity, on average US\$ 35-40 billion would need to be invested every year until 2030. Currently, people at the base of the pyramid spend US\$ 500 billion on energy each year to meet their cooking, lighting, communications and income generation needs. This section examines the case of a fast-growing SME which produces, installs, and operates 25-100 KVA plants in rural India, with its own mini-grid, at no fee for the village and the potential of scaling the venture via hybrid financing strategies.

The previous sections looked at three examples of social entrepreneurs working on global challenges in the fields of football for development, sanitation, and solid waste management, and their use of and potential for hybrid financing strategies. Generalizing across the cases of SFW, WTO and HCG, it is interesting to note that in face of large-scale social challenges, even very well-known social enterprises that have achieved widespread endorsement in the Ashoka, Schwab and Skoll networks can nevertheless be fairly small organizations, operating on a US\$ 500,000 to US\$ 10 million annual budget. The three cases analyzed are all mainly grant funded. They are now all experimenting with hybrid financial models to reach a scale where they can be expected to make a significant impact on the issues they are tackling.

Let us now look at a fourth example of a social entrepreneur, this time operating at the extreme end of the public good / private good social entrepreneurship continuum. Operating like a SME, Husk Power Systems (HPS) is active in the field of access to renewable energy for all. This is a key theater of social entrepreneurship. The transition to a low-carbon economy will impact all industries either directly or indirectly. Investments in energy saving, energy efficiency and clean energy can be financially attractive and make an important contribution to CO² reduction objectives. It is estimated that 1.5 billion people have no access to electricity around the world and 85 percent of them live in rural areas. The United Nations estimates that on average US\$ 35-40 billion needs to be invested every year until 2030, for everyone to have access to reliable electricity.³⁴ Considering that 1.5 billion people still do not have access to electricity at all, and almost 3.9 billion people have no regular access to an electricity grid, there is also considerable scope for renewable energies to target both climate change and economic empowerment.³⁵

Access to energy provides a direct benefit in terms of poverty reduction and improved health. For example, the UN Millennium Project estimates the impact of providing electricity to a rural Philippine household at US\$ 81-150 per month due to "improved returns on education and wage income." For the poorest four billion people on the planet, access to modern, clean and safe energy is equivalent to entering a new life. In 2011, energy at the BoP meant mostly batteries, kerosene or paraffin lamps, or cooking with firewood or waste. Urban households may perhaps have a link to the grid – but it is notoriously unreliable, dangerous and informal. Women and girls in particular spend hours in collecting firewood or inhaling smoke over a dirty stove. A staggering 1.6 million people die every year due to the toxic effects of indoor air pollution from cooking fires. Lack of energy may be an inconvenience in the developed world, but it is a barrier to development of the most basic kind for low income populations.³⁶ Moreover, there is a market: despite being poorly served or even put at risk, the poor are paying for energy. People at the base of the pyramid spend US\$ 500 billion on energy each year to meet their cooking, lighting, communications and income generation needs.³⁷ As per the recent "Power to the People" report, the decentralized rural electrification market in India alone is worth US\$ 2.1 billion per year.³⁸ The International Energy Agency 2008 survey indicated that the electrification rate in India stood at 65% for the country as a whole. The condition was worse for rural areas,

with only a 50 percent electrification rate. Furthermore, the KPMG 2010 India Power report indicated that power consumption across India will double by 2020;³⁹ extrapolating this estimate for rural energy needs means the demand for power will grow by over 10 percent annually for the next 10 years. This is likely to be an underestimate: the power use divide between rural and urban area is wide, and 18,000 off-grid villages do not have access to power at all and are considered to be uneconomic to serve.

This means that providing adequate energy solutions makes a big difference, and this is the focus of HPS.^{40,41} Founded in 2007 by Ratnesh Kumar, Gyanesh Pandey, Charles Ransler and Manoj Sinha, employing 350 full-time equivalents in 2011 with estimated 2011 revenues of US\$ 2 million (up from US\$ 500,000 in 2010, US\$ 100,000 in 2009, and US\$ 7,450 in 2008), HPS is budget-wise within the range of the case study peer group considered in this paper. But the growth prospects and corresponding use of hybrid financing models are different. HPS provides off-grid power to rural Indian villages of approximately 500 households or around 200 shops and other small businesses through a standardized solution. The firm produces, installs, and operates 25-100 KVA plants with its own mini-grid at no fee to the village. HPS then enters into contracts with farmers and local rice mills to procure rice husks and other biomass waste at fixed rates. The firm generates electricity using this feedstock and distributes power using a point-to-point system that connects each household and business directly to the HPS power station. Households pre-pay US\$ 2/month and commercial enterprises pre-pay US\$ 2.50/month for customized packages of electricity uses. Additionally, HPS has devised a process to utilize its waste product of gasification process, rice husk char. Approximately two tons of rice husk char at each plant are rolled into unscented incense sticks every month and sold to channel partners in the local market. HPS is also expanding its sales model by partnering with electrical appliances and fast moving consumer goods (FMCG) manufacturers to channel their quality products directly to BoP customers in a cost effective manner. HPS sees a large opportunity to provide locally-based (decentralized), low-cost "mini-power plants" to electrify Indian villages. In 2011-2013, HPS plans to primarily target its "mini power-plant" technology to villages in India's "Rice Belt", which consists of more than 25,000 rural villages without power.⁴² Though electricity consumption in India is increasing by over ten percent a year, the low electricity penetration rate in rural areas indicates that HPS's growth is limited for now by its own scaling rate and not yet constrained by electricity demand.

The company's total landed cost of installation (including wiring, poles and construction) is around US\$ 750 per kW, which is approximately half the cost of solar panels of similar scale. HPS has been operating for four years, maintains power plant reliability of over 93 percent and has successfully implemented 75 power plants that power over 300 villages or hamlets. HPS is currently scaling at a rate of 3 power plants per week; it plans to accelerate to 5 plants per week in 2012. In 2011, HPS expected to generate positive cash flow from operations that will further boost its expansion plans.

HPS generates revenue from four sources: selling power to households, farmers, and commercial enterprises within villages; productizing by-product, rice husk char, into "incense sticks" and selling to channel partners; selling Certified Emission Reductions (CER); and channeling electrical appliances and FMCG products from corporate partners to rural customers. HPS is currently being validated for 125 CERs per plant and has signed a Letter of Intent with a European buyer for a blended price of EUR 10 per CER. Each power plant becomes operationally profitable within 90-150 days of its installation and breaks even in 3.25 years (without subsidies), with an estimated life of 12 years. HPS has identified and is targeting 25,000 villages in India itself as feasible implementation sites. Typically, one plant serves four adjoining villages and HPS plans to expand to 700 villages in 2011, 1,600 in 2012 and 3,500 in 2013. In its end-to-end renewable energy solution, HPS has four main sources of revenue (see **figure 6**):

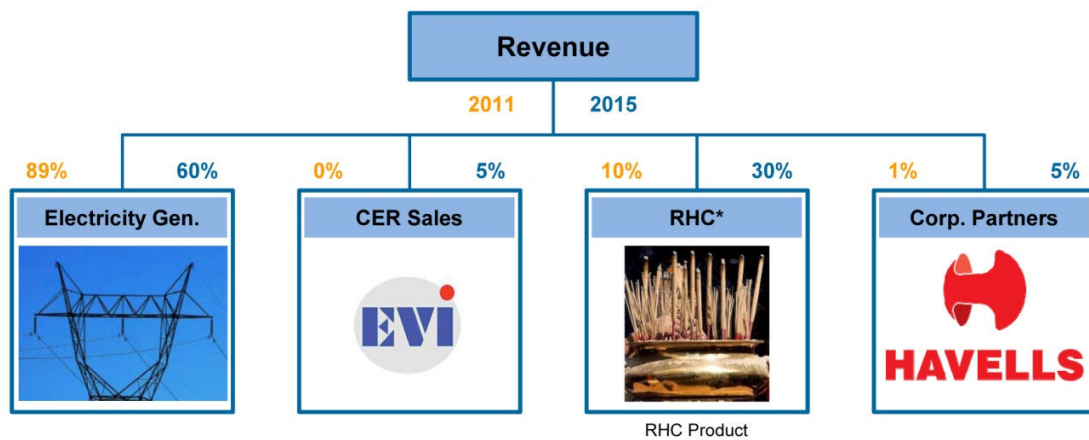


Figure 6: HPS revenue drivers, 2011 and 2015 estimates (Source: HPS)

How did HPS become a fast-growing SME, and how is its growth funded? One of the founders, Ratnesh Kumar, explains how HPS got started – and that getting to the fast-scaling model today was an iterative process, requiring initial “de facto grant funding” (angel funding which was basically lost experimenting to find the right business model):

“I returned to Bihar in 2003, to take care of family and business. While travelling through different parts of Bihar, I noticed that there is acute shortage/lack of electricity. After sunset life ceases to exist, everything would come to stand still. About 80% of the state population was dependent on kerosene or DG sets which are costly, polluting, dangerous and unhealthy. Then it came to my mind why don’t I do something in the energy sector. First we tried Jatropha plantation for bio diesel but it didn’t work because we couldn’t find wasteland in Bihar and 20,000 saplings that we had grown were wasted. Later we tried other options like wind and solar, before finally landing at biomass gasification in 2007. Since we already had a lot of failed projects and the money was going from our pocket we were very cautious and tried to do everything as low-cost as possible. The first plant went on the 15th of August 2007 (India’s Independence Day) in a village named Tamkuha which means ‘Fog of Darkness’.”

After personal angel funding, HPS developed a low cost “killer application” in renewable energy solutions and operates today under a sophisticated hybrid financing model. In 2008, HPS formed a strategic partnership with the Shell Foundation and received grant funding of US\$ 2.2 million, which has primarily been deployed towards R&D activities, recruitment of 7 senior managers and formation of Husk Power University for training 2,000 operators and mechanics by 2013. HPS has also received a total of US\$ 750,000 of subsidies from India’s Ministry of New and Renewable Energy. This grant-funded R&D and business building work provided the basis for other forms of funding, including mezzanine capital (see **concept 4**). In January 2010, HPS raised a convertible note of US\$ 1.7 million from a pool of investors that include Acumen Fund, Bamboo Finance (Oasis Capital), Cisco, Draper Fisher Jurvetson, LGT Venture Philanthropy, and the International Finance Corporation (IFC). HPS also entered into a long-term loan agreement with OPIC for US\$ 750,000.

Concept 4: Mezzanine capital (Convertible debt)

Mezzanine capital or convertible debt is a combination of debt and equity capital. It can be a useful alternative or complement to other funding sources, or if pure equity or debt capital cannot be accessed. Mezzanine instruments refer to either a subordinated debt or a preferred equity instrument which represents a claim on a social enterprise's assets. This means that repayment is required and ownership goes undiluted. The interest payment can be linked to the profits of the company whereas the total amount is repaid after a certain time period. Mezzanine financing is senior only to common shares and can be structured as unsecured debt or preferred stock. Given its higher risk, it is typically a more expensive financing source.

For its Series A share offering⁴³, in 2011 HPS was seeking equity capital of US\$ 5 million and debt capital of US\$ 7 million to fund the execution of its ambitious expansion plans to meet the 2013 target. Equity capital is scheduled to primarily be used to recruit and train senior and mid-level managers for operations, roll out a franchisee model and to support R&D activities geared towards streamlining operations. Debt capital is earmarked for purchasing equipment. Management also envisioned a "Series B" equity round of US\$ 15-20 million and around US\$ 30 million in debt, to enable the firm to expand to 12,500 villages by 2016. Alternatively, HPS may pursue strategic buyers or financial sponsors (private equity) and aim for a liquidity event for its investors in 2015.

8. Conclusion: Seizing the True Potential – Toward a Hybrid Financing Framework

The development of the field of impact investments, (or social finance, social investments, mission-related investments, depending on the reader's preferred wording), is accelerating. In the next decades, a more effectiveness and efficiency-minded approach to social change and social entrepreneurship will become the norm rather than the exception. Over the course of the decade, inspiring examples of transformational social entrepreneurs and social businesses will move from the creative frontier of the social sector to its core. This will also influence practice in the for-profit and public sectors. Understanding the true potential of hybrid financing strategies plays an important role in accelerating this development, because we cannot build an industry if we do not manage to fund the underlying ventures efficiently. Overall market studies are important to set investor expectations; it is similarly relevant to apply the different financing tools – grants, equity, debt and mezzanine – with great diligence and in ways that are fundamentally compatible with the underlying business model of the social entrepreneur in question. This section articulates a simple framework to help social entrepreneurs and investors alike to navigate as they express through market mechanisms the first principles that render our existence on this planet human: caring for others, sharing resources, and the desire to be recognized in historical time and make a difference.

Social enterprises face multiple challenges in building the scale required to make a significant impact on the large-scale issues that social entrepreneurs like to tackle. Access to capital is typically the binding constraint. This was also the conclusion of a meeting held at the Aspen Institute in September 2006, which examined social enterprises' difficulty under present laws to attract investment capital, whether from bank loans, venture capital, or in some other form.⁴⁴

Two primary sources of capital are in principle conceivable: commercial and philanthropic. However, commercial capital often avoids social enterprises, partly because of lower target returns and the greater difficulty of conceptualizing in the language of the capital markets business models that generate both social and financial returns.

Based on the experiences reviewed, we can conclude that almost all successful social enterprises use diachronic hybrid financing, either opportunistically or in a pre-planned, strategic fashion. Grants remain the best way to seed fund a social enterprise, but later tend to become insufficient in providing the capital required when the venture scales.

Whether synchronic hybrid financing makes sense or not depends on the specific problem the social entrepreneur is trying to solve, as well as the ability to distinguish and delimit the different elements of the organization's value chain. The confidence of providers of risk capital is won more easily whenever some kind of "killer application" can be easily implemented in scale, perhaps even technology-based. Used intelligently, hybrid funding models can also leverage scarce resources, for example first-loss tranches or guarantees which serve as a catalyst to bringing additional commercial capital to the table. In the BoP and the industrialized world alike, the specific combinations differ depending on the type of social venture considered.

Public good social entrepreneurs require grant and technical assistance funds, but typically little debt and equity for the core business, if at all. As the case of SFW and WTO showed, a successful public good social entrepreneur can develop "private good" type initiatives that justify hybrid funding. Consider raising risk capital for the funding of a specific product to be developed, such as a low-cost toilet meeting pent-up demand for one billion affordable toilets around the world; or, where a specific product is not an option, consider raising capital to develop additional revenue gathering channels, as in the case of SFW.

On the other hand, private-good social entrepreneurs typically benefit from a combination of debt and equity capital, paired with technical assistance and capacity building grant funds. This is most obvious where social entrepreneurship borders on commercial entrepreneurship, as in the case of microfinance and SMEs. In the field of microfinance the great challenge is to seed fund the next generation of early-stage microfinance institutions, taking them to sustainability/profitability. This requires some additional risk appetite, given the fact that current mainstream debt and equity capital inflows into microfinance tend to be mainly allocated to top-tier microfinance institutions, while second-tier institutions often face growth constraints due to lack of risk capital. The second tier benefits from hybrid combinations of grant funding with increasing debt and equity funding as the venture scales and achieves critical mass and maturity. The microfinance industry also shows that staying on the social mission cannot be regarded as an automatic given when a social enterprise grows, as is well highlighted by the recent controversial case of SKS Microfinance (see **case below**).

Founded by Indian-American social entrepreneur Vikram Akula, SKS Microfinance Limited (SKSM: Natl India; hereinafter "SKS") is the first listed microfinance institution (MFI) in Asia. It has inspired both admiration for its ability to rapidly scale its microfinance offering, as well as skepticism and downright criticism surrounding the firm's IPO and its role in the recent Indian microfinance crisis, where some of SKS' clients committed suicide (which they were reported to have seen as the only way out of their own over-indebtedness). SKS recently posted a loss of US\$ 15.6 million for the first quarter of 2011; its share price dropped from a high of 1,491.50 rupees in September 2010 to 208 rupees on September 2, 2011. SKS is an instructive case with respect to the prospects of hybrid funding strategies, because SKS got started with grant funding and later moved into other forms of financing before it became publicly listed.

Originally formed as a NGO in 1997, SKS delivers microfinance products to poor women in India through a group-lending model. SKS became a for-profit in 2005. Three strategic choices helped to rapidly build scale. First, SKS developed a for-profit model to be able to access commercial capital; second, to scale up, it modeled its processes upon best practices from the business world to displace capacity constraints; and finally, SKS relied heavily on technology to achieve process automation and lower cost. SKS was incorporated as a non-banking finance company (NBFC) which converted to a public limited company in May 2009 and launched an initial public offering on July 28, 2010 on the Indian stock exchange. The IPO raised US\$ 358 million and valued the company at US\$ 1.5 billion; it is regulated by the Reserve Bank of India. According to 2010 data from the Microfinance Information Exchange (MIX) which serves as the microfinance industry's information clearinghouse, SKS reported total assets of US\$ 1.2 billion, a gross loan portfolio of US\$ 1.2 billion, return on assets (ROA) of 6.3 percent and return on equity (ROE) of 22.4 percent. By March 2011, it had 22,000 employees, 7.3 million clients, and was operating across 378 districts in India with total loans of US\$ 4.99 billion disbursed. SKS is an interesting case for the development path of social enterprises for three reasons: the recognition of the founder as a social entrepreneur, the company's scale, and its profitability. First, setting up SKS as a mission-oriented social enterprise, its founder won the Echoing Green Public Service Entrepreneur Fellowship (1998-2002), the Social Entrepreneur of the Year award in India (2006), and the World Economic Forum's Young Global Leader award (2008). This focus on the individual is a representative example of the social entrepreneurship field that typically celebrates pioneers and leaders. Second, when SKS went public, controversy arose as it was not immediately clear how the upside that accrued to grant-funded organizations who had taken an equity stake in SKS would be used. As we saw earlier, social entrepreneurs almost always start out with grant funding – and this raises questions as to how upside should be distributed if it ever materializes. In the SKS case, the spotlight turned on two charitable microfinance groups who had helped SKS in an earlier development stage, namely five Indian

trusts that held the assets of the original non-profit version of SKS, as well as Seattle-based Unitus, which held a stake in SKS worth millions post-IPO. Unitus' communicated stance at the time of the IPO was to lay off the organization's forty staff and exit microfinance activities. This surprised donors of Unitus, who had funded the organization for a decade specifically to support microfinance. At the time, Muhammad Yunus, the founder of the Grameen Bank argued "If Unitus is closing down, that shows what is the real result of this I.P.O. [...]. You are now encouraging the profit-maximizing part, and the non-profits are closing down." Interestingly, the unwinding of Unitus contrasted with the strategy adopted by Acción, another non-profit microfinance field-building organization, which used a US\$140 million windfall from the 2007 public offering of the Mexican micro lender Compartamos to expand its microfinance operations; moreover, at Acción, executives and directors had no investments in Compartamos. Third, perhaps even more fascinating than the questions surrounding the personality of the social entrepreneur and what happens in terms of profit-taking from an IPO exit of an originally grant-funded operation, is the question related to how to safeguard the social enterprise DNA of a large company on a public market. SKS continues to aspire "to serve 50 million households across India and other parts of the world and also to create a commercial microfinance model that delivers high value to our customers", using standardized processes of delivering and recovering loans to be able to reach out to customers at the BoP effectively. Whether this is possible on a public market in the long run, or whether under certain conditions social enterprises de facto exit the social entrepreneurship space is still an unresolved question. In 2011, the social entrepreneurship field had merely started to conceptualize the conditions under which a social entrepreneur would lose that status, and attempts to establish specialized "social" stock exchanges that combine triple bottom line considerations with capital aggregation and liquidity typical of stock markets were still in their infancy.

The case of SKS Microfinance Ltd.

In due course, we can expect the social entrepreneurship SME space to face opportunities and challenges to microfinance. Small and medium enterprises make good candidates for hybrid funding, in particular to grant fund market studies and capacity building for expansion paired with debt and equity. This is particularly promising in the event of a "killer application" that needs to be rolled out, such as HPS' low-cost renewable energy solution referred to earlier. In India alone, the total target market for HPS' "mini power-plants" consists of 125,000 un-electrified villages.⁴⁵ In 2011, the country's total rural energy market was valued at US\$ 102 billion, of which the De-Centralized Rural Energy (DRE) market spending was estimated at US\$ 2.11 billion/year.⁴⁶ Given that over 90 percent of rural energy usage comes from fossil fuels, and the Indian Government has deemed 18,000 villages to be "economically impossible" to service, the impact and business opportunity is enormous; the operational challenges will be considerable.

This paper focused mostly on the use of hybrid financing models to unlock the full potential of a social enterprise's to serve pent-up demand. Fulfilling the estimated trillion dollar potential of the impact investment field will require some intelligent combination of grant and for-profit funding, as well as other measures to source social entrepreneurs and then enable them to grow their impact. The specifics vary according to case and industry, but being systematic and cooperative is key; also, new regulatory environments, incentive systems and institutions, such as the social impact bond and social stock exchanges will be needed to seize the full potential.

Hybrid funding strategies in social entrepreneurship also play an important role at the level of the investment vehicle. Many challenges remain concerning the design of specialized financial products to finance public and private good social entrepreneurs. They include cost-effective due diligence processes, the identification of a critical mass of reliable deal flow, as well as technical challenges regarding product design. The experience of microfinance shows that to

operate at a reasonable scale and risk characteristics, most for-profit social investment opportunities require philanthropic capital somewhere in the background. This can be in the form of technical assistance and capacity-building grants, or of first-loss commitments or loan guarantees that transform junk paper into investment grade. In the field of microfinance, international financial institutions such as the International Finance Corporation (IFC) as well as private philanthropists had to provide such philanthropic capital for years, before a market for microfinance capital on commercial terms could emerge.

In the industrialized world, with a significant presence of the state in public good provision, one key question for hybrid funding of social entrepreneurs will be how to engage the public sector. There is a case for hybrid models involving public sector funding whenever social entrepreneurs have provided proof of concept of a more efficient solution but there are barriers to scale and replication, and when capital markets can be used to raise risk capital for scaling and replication and to monetize grant commitments. Specifically: (1) whenever addressing a problem now is cheaper than addressing it in the future when the grant commitment is actually paid out, (2) when new market places need to be constructed, or (3) when the most efficient solution provider is not a government agency. The social impact bond referred to earlier consists of a case-based combination of private risk funding to unlock government resources upon the achievement of a social metric.

In a top-down industry view, seeking optimal use of hybrid funding models, one must furthermore look beyond how individual social ventures can benefit from hybrid funding models to scale. An important development in the creation of a more funding-friendly environment for social enterprises in general is taking their blended social and financial returns into explicit consideration in the design of legal vehicles, thus providing standardized funding solutions that reduce transaction costs and enhance liquidity. Institutionalizing the concept of a "for-profit social enterprise" recognizes that organizations can reconcile the twin goals of social impact and financial return.

Historically, charitable foundations seeking to invest in social enterprises with such blended returns faced a specific set of challenges, which were to a significant extent regulatory. For example, under US tax laws, non-profit foundations can make "program related investments" (PRI) into such profitable organizations that further the charitable cause of the foundation.⁴⁷ Recently, several initiatives have begun to address this challenge. The most well-known today are the Low-Profit Limited Liability Company (L3C) in the US and the Community Interest Company (CIC) in the UK; together with other initiatives, such as a new proposed UK business structure called the Social Enterprise Limited Liability Partnership (SELLP), or the B Corporation,⁴⁸ they will eventually contribute to greater standardization of hybrid funding solutions.

On the European continent, there have been legislative framework changes as well. For example, in Italy, with the mounting pressure on the welfare state, an increase in the development of social entrepreneurship can be expected, as is already the case in other countries.⁴⁹ The "Libro Bianco sul futuro del modello sociale" ("White book on the future of the social model"), published by the Italian government in 2009, highlights the possible role of the third sector in Italy's social system and points out the need to push for impact, innovation and efficiency in the non-profit sector. Associations and cooperatives remain the preferred option, but social entrepreneurship organizations are becoming increasingly important. This "imprese sociali" sector includes all those organizations, including the social cooperatives already discussed, whose economic activities are stable and aimed at producing and exchanging goods and services targeting the public good and public interest. Legislation concerning social entrepreneurs is contained in law 118/05 and was later refined and made organic with the legislative decree 155/06 and via four decrees in 2008. An Italian social enterprise must operate in one or more of the following fields: social care, health care, education, training, preservation

of the environment, preservation of the cultural heritage, university education, extracurricular education, or social tourism. While this is a broad classification, there are some structural requirements which make the "impresa sociale" more specific: involvement of workers and stakeholders; profits reinvested in company development; financial and social return. Hybrid financing models are thus key. In 2009, there were approximately 517 organizations who adhered to the principles set by the new legislation on social entrepreneurship and could therefore be classified as "imprese sociali" (although many of those were private schools who found it practical to use this structure).

Jointly, the different innovations in hybrid financing models and enabling environments can be expected to overcome the deep inefficiency of the social capital market over time. This will result in greater opportunities for social impact paired with financial returns. There is some way to go. The transaction cost of allocating capital in the non-profit sector has been estimated at 22-43 percent (compared to 2-5 percent on the stock market), and up to 85 percent in development aid. Diachronic and synchronic hybrid funding models for social entrepreneurs can allocate capital more efficiently, by applying basic techniques and concepts that have been commonplace in capital markets and investment banking for many years. To make proper use of them, it is essential to grasp the underlying ability of a social enterprise to absorb different forms of capital in order to thrive.

The trillion dollar question is not whether the impact investment field will ultimately materialize, but how fast, and which steps can be undertaken to accelerate the process. Capital is key, but so are research and strategy, technology to manage information efficiently, and partnerships that enable social entrepreneurs to access the deep industry and local knowledge of the business sector and vice versa. Seizing the true potential of hybrid financing for social entrepreneurs is a key theater of impact investing. To deliver by the end of the decade, we need to act intelligently along the following vectors: a realistic use of financing instruments by investors and investees; a generally greater investibility of social entrepreneurs to build a pipeline of investment opportunities; scalable mechanisms that provide grant and non-grant capital at lower transaction cost; information technology platforms to drive impact and manage complexity; and, finally, legal structure innovation. A lot remains to be done, but we can expect the overall rising skepticism towards mainstream capital markets, paired with increasing government debt and a private sector increasingly looking for social-business win-win engagement opportunities, to give social entrepreneurs a hand as they strive for reaching their full impact potential.

9. Suggestions for Further Reading

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10. Author Information, Acknowledgements, Partners

Author Information

Dr. Maximilian Martin is the Founder & Managing Director of Impact Economy SA. He currently also serves as Founding Faculty in Residence at AshokaU and as a Lecturer in Social Entrepreneurship at the University of St. Gallen.

Dr. Martin is passionate about convergence between the spheres of knowledge, business and the public good. His previous work includes creating Europe's first wealth management philanthropic advisory and knowledge exchange platform, UBS Philanthropy Services and the UBS Philanthropy Forum (2004-2009), which he established as the Bank's global lead offering for the ultra-high net worth segment and an industry benchmark, recognized as the world's top philanthropic service by Euromoney in 2007. Previously, he also created the first university course on social entrepreneurship in Europe at the University of Geneva in 2003. Other engagements have included serving as Global Head and Managing Director of UBS Philanthropy Services, Visiting Professor at the University of Geneva, Head of Research at the Schwab Foundation for Social Entrepreneurship, Senior Consultant with McKinsey & Company, instructor at Harvard's Economics Department, and Fellow at the Center for Public Leadership at the Harvard Kennedy School. Dr. Martin serves on several international governing, sustainability and advisory boards, and has authored over one hundred articles on social business and philanthropy, corporate responsibility, impact investments, and related topics. He holds an MA in anthropology from Indiana University, a MPA from Harvard University and a Ph.D. in economic anthropology from the University of Hamburg.

He can be contacted at: maximilian_martin@impacteconomy.com

Impact Economy

Impact Economy SA is a social finance and strategy firm based in Geneva. Our team on two continents provides knowledge, executive education, strategy advisory, governance and financial services to enable individuals, institutions and companies to participate fully and meaningfully in the current transition to the new paradigm of sustainability capitalism or "impact economy". We define impact economy as the landscape of market mechanisms, entrepreneurial methods and institutional incentives providing goods and services to, or use the productive capabilities of poor or otherwise disadvantaged sections of the population, thereby making an important contribution to wider social transformation and sustainability objectives. Our broad range of clients benefits from the experience, networks and processes built by our leadership team in the past decade, having launched Europe's first philanthropic services department for a large bank, Europe's first university course on social entrepreneurship, and taken part in several important innovations in philanthropy and social finance around the world.

See www.impacteconomy.com.

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Launch Partners

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11. Endnotes

¹ See Oldenburg, Felix, May 26, 2011, "The Dangerous Promise of Impact Investing" (<http://www.nextbillion.net/blog/2011/05/26/the-dangerous-promise-of-impact-investingfrom-ashoka-europe>) and the reply: Granier, Michel, July 6, 2011, "The (Not So) Dangerous Promise of Impact Investing" (<http://www.nextbillion.net/blog/2011/07/06/the-not-so-dangerous-promise-of-impact-investing>).

² The world's social capital market is already large and growing: Germany's social spending alone exceeds EUR 154 billion a year; around the world, high net worth philanthropy currently allocates approximately US\$ 300 billion per annum; charitable foundation endowments around the world command assets in excess of US\$ 800 billion; and the US government grants in excess of US\$ 500 billion a year to non-profits.

³ See Monitor Institute, 2009, "Investing for Social and Environmental Impact" (www.monitorinstitute.com/impactinvesting/documents/InvestingforSocialandEnvlImpact_FullReport_004.pdf)

⁴ See JP Morgan Global Research, the Rockefeller Foundation and the Global Impact Investing Network, 2010, "Impact Investments: An Emerging Asset Class", London and New York: JP Morgan Global Research (www.jpmorgan.com/cm/cs?pagename=JPM/DirectDoc&urlname=impact_investments_nov2010.pdf).

⁵ A way to benchmark would be to comparatively analyze the funding strategies of the leading networks of social entrepreneurs, e.g. Ashoka Fellows, Echoing Green Fellows, Skoll Fellows, and Schwab Social Entrepreneurs. The challenge however remains that the different networks operate with overlapping rather than identical definitions of social entrepreneurship, that many self-assigned social entrepreneurs are not part of these organized networks, and that not all networks collect and verify sufficient data to complete such a comprehensive study. Regarding "investible social entrepreneurs", an alternative approach consists of analyzing the funding strategies of social entrepreneurs who are investees of investment vehicles such as LGT Venture Philanthropy or Bamboo Finance who brand themselves as investors in social entrepreneurship. Either way, a lot of empirical work still needs to be done to describe the universe of social entrepreneurship funding strategies in detail.

⁶ See C.K. Prahalad, 2004, "The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits", New York: Prentice Hall.

⁷ We define capital stage as expansion phase, i.e. the scale-up of business operations through resources, infrastructure and human capital investment.

⁸ See www.ignia.com.mx

⁹ See Social Finance, "Social Impact Bonds: Rethinking Finance for Social Outcomes", London: Social Finance, 2009; Social Finance, "Towards a New Social Economy: Blended Value Creation through Social Impacts Bonds", London: Social Finance, 2010; Martin, Maximilian, 2011, "Four Revolutions in Global Philanthropy. Impact Economy Working Paper 1", Geneva: Impact Economy (www.impacteconomy.com/four-revolutions-global-philanthropy).

¹⁰ See Martin, Maximilian, 2004, "Surveying Social Entrepreneurship: Toward an Empirical Analysis of the Performance Revolution in the Social Sector", Working Paper, Center for Public Leadership 2, University of St. Gallen, (<http://www.impacteconomy.com/node/175>); Martin, Maximilian. 2008, "Investing in the Emerging Social Enterprise Landscape", Viewpoints, 108-115 (<http://www.impacteconomy.com/investing-emerging-social-enterprise-landscape>).

¹¹ Martin, Maximilian, 2008, "Investing in the Emerging Social Enterprise Landscape", Viewpoints, 108-115 (<http://www.impacteconomy.com/investing-emerging-social-enterprise-landscape>).

¹² SMEs are typically in the real sector. The "real sector" refers to economic activity in the primary (agriculture), secondary (industry) and tertiary (services) sectors, except financial services.

¹³ Analogously to the "base of the pyramid" (BoP), consisting of 4 billion people who are poor, we define the target segment "top of the pyramid" (ToP) as specific communities within the remaining 2.8 billion people living largely in industrialized countries or transition economies who suffer from patterns of exclusion from the economic mainstream in spite of generally much higher aggregate income levels.

¹⁴ A contingent return model links a financial reward to achievement of a social or environmental outcome, as in the case of the social impact bond mentioned in the paper.

¹⁵ SFW was chosen for the study because of its prominent positioning in its chosen field. This subsection relies on information provided by the leadership of SFW in interviews, a completed questionnaire, documentary evidence such as the annual report, and publicly available information.

¹⁶ For a comparison with a larger organization not exclusively focused on football, see also Right to Play, with a 2009 budget of US\$ 28.5 million (http://www.righttoplay.com/International/news-and-media/Documents/FinancialReports/RightToPlayFinancials_2009.pdf).

¹⁷ SFW has received numerous awards, including the FIFA Fair Play Award (2006), Laureus Sport for Good Award (2006), Ashoka Fellowship (2007), Member of FIFA's Commission for Fair Play and Social Responsibility (2008), Ashoka Globalizer (2009), Global Sports Forum (2010, FIFA and streetfootballworld), Peace and Sport (2010, FIFA and streetfootballworld), and Schwab European Social Entrepreneur of the Year (2011).

¹⁸ Hybrid Financing Study Questionnaire: streetfootballworld, 2011, Geneva: Impact Economy.

¹⁹ See SFW and World Bank, estimates based on World Bank Poverty Report 2008, Washington, DC: World Bank (<http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:21882162~pagePK:64165401~piPK:64165026~theSitePK:469382,00.html>)

²⁰ Meehan, William F., Kilmer, Derek, and O'Flanagan, Maisie, "Investing in Society", Stanford Social Innovation Review 1 (4), 2004, 34-43.

²¹ See <http://www.avina.net> and http://www.lgt.com/en/private_kunden/philanthropie/index.html.

²² While the football industry is not strictly comparable to OECD countries, it is nevertheless interesting to note that this figure represents about half of the 0.7 per cent of gross national income which donor countries committed to development aid in 1970 (of course, only a few donor countries have delivered on the magnitude of their promises so far).

²³ See <http://www.un.org/millenniumgoals/>.

²⁴ See Lane, Jon, "Imagine all the People Living in a World with Toilets", Viewpoint, 2010 (<http://www.thegiin.org/cgi-bin/iowa/resources/research/57.html>)

²⁵ See <http://www.worldtoilet.org>. WTO was chosen for the study given its prominent positioning in its chosen field. This subsection relies on information provided by the leadership of WTO in interviews, a completed questionnaire and documentary evidence, and publicly available information.

²⁶ Jack Sim also established the Restroom Association of Singapore (RAS) in 1998, which addresses the state of dirty public toilets in designs, building codes and poorly trained cleaners. In 2004, he was awarded the inaugural Singapore Green Plan Award by Singapore's National Environment Agency for contribution to the environment. In 2005, Jack founded the World Toilet College in Singapore to provide high quality training in Toilet Design, Maintenance, Cleanliness and Ecological Sanitation Technologies. The college is a joint venture with the Singapore Polytechnic. In 2005, he successfully lobbied for "potty parity" and changed Singapore's building codes to have more cubicles in women's restrooms. US Congress passed a similar law in 2010. WTO and its founder Jack Sim were named Social Entrepreneur of the Year Singapore 2006, Time Magazine Hero of Environment 2008, Schwab Social Entrepreneur of the World Economic Forum, Ashoka Global Fellow, Channel News Asia's Asian of the Year 2009, and Asian Development Bank's Water Champion.

²⁷ For a discussion, see also World Economic Forum, 2011, "Water Security: The Water-Food-Energy-Climate Nexus" (http://www3.weforum.org/docs/WEF_WI_WaterSecurity_WaterFoodEnergyClimateNexus_2011.pdf)

²⁸ Communication to the author, May 17, 2011.

²⁹ Communication to the author, May 17, 2011.

³⁰ See <http://www.sanitationfinance.org>

³¹ See www.ciudadasaludable.org. HCG was chosen for the study given its prominent positioning in its chosen field. This subsection relies on information provided by the leadership of HCG in interviews, a completed questionnaire and documentary evidence, and publicly available information.

³² See http://www.lgt.com/en/private_kunden/philanthropie/index.html

³³ A letter of credit is a legally binding document requested by the buyer from his bank to guarantee that payment for goods purchased will be transferred to the vendor. The letter of credit provides the seller reassurance to receive the payment for the goods. For the payment to take place, the seller must present the bank with the required shipping documents which confirm shipment of the goods ordered within a given timeframe. Letters of credit are used in international trade to mitigate common risks such as lack of familiarity with the export country, customs requirements, or political instability.

³⁴ "Energy in the Developing World: Power to the People", September 2, 2010, The Economist (<http://www.economist.com/node/16909923>).

³⁵ For a discussion, see Martin, Maximilian, 2010, "After Copenhagen: Perspectives on Energy", Viewpoint 2010, 54-64 (<http://www.impacteconomy.com/after-copenhagen-perspectives-energy>).

³⁶ Access to energy for low-income people means choices about what to do at night, improved health and safety, and the ability to direct scarce financial resources to more productive uses.

³⁷ Measured at purchasing power parity (PPP).

³⁸ See Center for Development Finance and World Resources Institute, 2010, "Power to the People: Investing in Clean Energy for the Base of the Pyramid in India" (http://pdf.wri.org/power_to_the_people.pdf)

³⁹ KPMG India, 2010, "*Power Sector in India: White Paper on Implementation Challenges and Opportunities*" (http://www.in.kpmg.com/TL_Files/Pictures/PowerSector_2010.pdf)

⁴⁰ Husk was chosen for the study as an example for a fast-growing social enterprise SME with diversified hybrid financing. This section relies on information provided by the leadership of HPS in a completed questionnaire, a panel discussion moderated by the author on May 27, 2011 in Zurich, Switzerland, documentary evidence, and publicly available information.

⁴¹ The Founders of Husk Power Systems, Ratnesh Kumar, Gyanesh Pandey, Charles Ransler, Manoj Sinha, have received numerous awards for their work, namely 2nd Place, 2008 MIT Ignite Clean Energy Competition, 1st Place, 2008 Dell Social Innovation Competition, named "PopTech 2008! Fellow", named "Social Entrepreneurs of the Year" for 2008 by FastCompany Magazine, named GSBI 2009 Fellow, 1st Place, 2009 DFJ/CISCO Global Business Plan Competition, 2010 Sankalp Award (Economic Development), 2010 Tech Awards Laureate for "Economic Development", and 2010 BBC World Challenge finalist.

⁴² The Indian Rice Belt consists of the states of Bihar, West Bengal, Orissa, Uttar Pradesh, Madhya Pradesh, Andhra Pradesh and Northeastern states.

⁴³ Series A Shares typically are the most preferred tier of classified shares and offer more voting rights than later rounds of funding via Series B Shares etc.

⁴⁴ Billitteri, J., 2007, "*Mixing Mission and Business: Does Social Enterprise Need a New Legal Approach?*", The Aspen Institute (<http://www.aspeninstitute.org/publications/mixing-mission-business-does-social-enterprise-need-new-legal-approach>)

⁴⁵ Villages are identified as "un-electrified" if power is either available only to a minority of the population or is not consistently available.

⁴⁶ World Resources Institute, 2010, "*Power to the People: Investing in Clean Energy for Base of Pyramid in India*", World Resources Institute Report (<http://www.wri.org/publication/power-to-the-people>)

⁴⁷ PRI investments are beneficial to a foundation as they count as part of the required 5 percent payout and are not booked as part of the endowment. This means they do not count towards calculation of the next year's 5 percent payout requirement and any capital gain is not included in the excise tax. So PRI investments, unlike regular endowment investments, are a kind of "off the books" investment – to be dealt with only when they earn income or are sold. Even then, rules are simple – any income or gains must be given away or reinvested in another PRI within the same year in addition to the 5 percent already allocated for that year. Despite these many benefits, PRIs have not been widely adopted in the US.

⁴⁸ Certified B Corporations are a new type of corporation which "uses the power of business to solve social and environmental problems". They meet comprehensive and transparent social and environmental performance standards and meet higher legal accountability standards. To become a B Corporation, a company must undertake the following three steps: take and pass the B Impact Ratings System, which aims to set a benchmark for social and environmental impact for "good companies"; adopt the B Corporation Legal Framework to codify the mission of the company into its legal DNA, and finally sign a Term Sheet that renders the certification official. See www.bcorporation.net/about.

⁴⁹ For further analysis on the development of social enterprises in Italy, see [www.portalecnel.it/portale/documenti.nsf/0/C12575C30044C0B5C12576AC0057B027/\\$FILE/impresa%20sociale.pdf](http://www.portalecnel.it/portale/documenti.nsf/0/C12575C30044C0B5C12576AC0057B027/$FILE/impresa%20sociale.pdf)